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In the Supreme Court of the United States

OCTOBER TERM, 1944

No. 703

AMERICAN LIBERTY PIPE LINE COMPANY,
PETITIONER

v.

COMMISSIONER OF INTERNAL REVENUE

ON PETITION FOR A WRIT OF CERTIORARI TO THE UNITED STATES CIRCUIT COURT OF APPEALS FOR THE FIFTH CIRCUIT

BRIEF FOR THE RESPONDENT IN OPPOSITION

OPINIONS BELOW

The findings of fact and opinion of the Tax Court of the United States (R. 33–50) are reported in 2 T. C. 309. The opinion of the Circuit Court of Appeals (R. 175–181) is reported in 143 F. 2d 873.

JURISDICTION

The judgment of the Circuit Court of Appeals was entered on July 14, 1944 (R. 181). The petition for a writ of certiorari was filed on November 25, 1944, pursuant to an order granting an exten-

sion of time (R. 182). The jurisdiction of this Court is invoked under Section 240 (a) of the Judicial Code, as amended by the Act of February 13, 1925.

QUESTION PRESENTED

Whether, within the intendment of Section 26 (c) (2) of the Revenue Act of 1936, the taxpayer corporation was required by a provision of a written contract executed by the corporation prior to May 1, 1936, to apply its earnings of the taxable year in discharge of a debt incurred prior to the same date.

STATUTE INVOLVED

Revenue Act of 1936, c. 690, 49 Stat. 1648:

SEC. 26. CREDITS OF CORPORATIONS.

In the case of a corporation the following credits shall be allowed to the extent provided in the various sections imposing tax—

* * * * *

(c) *Contracts Restricting Payment of Dividends.*—

* * * * *

(2) *Disposition of profits of taxable year.*—An amount equal to the portion of the earnings and profits of the taxable year which is required (by a provision of a written contract executed by the corporation prior to May 1, 1936, which provision expressly deals with the disposition of earnings and profits of the taxable year) to be

paid within the taxable year in discharge of a debt, or to be irrevocably set aside within the taxable year for the discharge of a debt; to the extent that such amount has been so paid or set aside. For the purposes of this paragraph, a requirement to pay or set aside an amount equal to a percentage of earnings and profits shall be considered a requirement to pay or set aside such percentage of earnings and profits. As used in this paragraph, the word "debt" does not include a debt incurred after April 30, 1936.

STATEMENT

Taxpayer was incorporated in Delaware on December 27, 1935 (R. 39), for the purpose of unifying and extending pipe-line systems which were already owned or controlled by its three promoters. Prior to incorporation, the promoters initiated negotiations with the Republic National Bank and Trust Company of Dallas, Texas, to secure necessary financial assistance for the project. (R. 34–35.) In a letter to the promoters on December 13, 1935, the bank agreed to loan taxpayer, when organized, $1,250,000, secured by first mortgage 6% two-year notes, payable quarterly out of three quarters of taxpayer's net earnings, this loan to be made "as and when the following stipulations and conditions have been fully met and complied with" (R. 37). The conditions mentioned included full completion of the con-

templated pipe-line construction on or before June 30, 1936, the bank expressly disclaiming any obligation unless this condition was fulfilled. Two of the promoters entered the notation "accepted" on the last page of this letter. (R. 37–38.) Thereafter, taxpayer was incorporated, with the promoters as directors and officers (R. 39). Contracts were then entered into with three companies for the pipe-line construction. The promoters secured each of these contracts with assignments of portions of the bank's conditional agreement of December 13, 1935. (R. 39–40.)

On May 30, 1936, the consulting engineer employed by the bank reported completion of the pipe line,[1] and on June 11, 1936, taxpayer advised the bank that the conditions mentioned in the conditional agreement had been performed (R. 41–42). Taxpayer executed a deed of trust and chattel mortgage to the bank, as trustee, on June 18, 1936, to secure payment of notes aggregating $1,250,000 funded by the bank. The proceeds of this loan were immediately made available to taxpayer, and checks were issued to the contractors in accordance with the assignments. (R. 42.) Pursuant to the terms of the deed of trust, periodic payments from taxpayer's earnings were made to the bank to apply on the principal and interest due on the notes (R. 42–43). In 1938 taxpayer

[1] The engineer had previously reported that the project was approximately 95% completed on May 2, 1936 (R. 41).

refinanced its business through a new loan from the Bank of Manhattan Company. This loan was also secured by a deed of trust on taxpayer's properties, and it was stated that the indebtedness was in renewal and extension of the balance still outstanding under the June 18, 1936, loan. (R. 43.)

In its tax returns for the fiscal years ending 1937 and 1938, taxpayer claimed a credit under Section 26 (c) (2) of the Revenue Act of 1936 (*supra*, pp. 2–3) for payments made under both the loan of June 18, 1936, and the subsequent loan. The Commissioner disallowed this credit and determined a deficiency. (R. 19.) The Tax Court upheld the Commissioner's determination (R. 50) and this decision was affirmed by the Circuit Court of Appeals (R. 181).

ARGUMENT

The credit allowed by Section 26 (c) (2) of the Revenue Act of 1936 (*supra*, pp. 2–3) is expressly conditioned upon the existence of a written contract executed by the taxpayer prior to May 1, 1936, relating to the discharge of a debt incurred prior to the same date. Since this credit is in the nature of a special deduction, the taxpayer is required to demonstrate strict compliance with all of these conditions. *Helvering* v. *Ohio Leather Co.*, 317 U. S. 102, 106; *Helvering* v. *Northwest Steel Mills*, 311 U. S. 46, 49. In hold-

ing that the taxpayer failed to sustain this burden, the courts below correctly decided a question which does not call for further review.

The only writing in existence prior to May 1, 1936, dealing with the disposition of taxpayer's earnings is the bank's conditional agreement of December 13, 1935.[2] The holding of the Circuit Court of Appeals that this letter did not constitute a contract within the purview of the statute is squarely in accord with decisions of other circuits. *Rahr Malting Co.* v. *United States* (C. C. A. 7th), decided November 16, 1944 (1944 P-H, par. 62, 767); *Florence Cotton Mills* v. *Commissioner*, 126 F. 2d 1017 (C. C. A. 5th); *Bethlehem Silk Co.* v. *Commissioner*, 124 F. 2d 649 (C. C. A. 3d); *Morgan Mfg. Co.* v. *Commissioner*, 124 F. 2d 602 (C. C. A. 4th). Under these decisions, the letter was at most a unilateral offer which did not ripen into a binding contract until its conditions were fulfilled. Taxpayer has failed to make any showing that these conditions were met before May 1, 1936. In fact it affirmatively appears that the condition relating to the pipe-line completion was not complied with until after this date (R. 41). And clearly there was no contract relating to a disposition of taxpayer's earnings enforceable by the bank until the loan was actually made on June 18, 1936. *Rahr Malting Co.* v. *United*

[2] The first deed of trust was not executed until June 18, 1936 (R. 42).

States, supra; cf. *Central West Coal Co.* v. *Commissioner,* 132 F. 2d 190 (C. C. A. 7th).[3]

Moreover, the conditional agreement was executed by the promoters and not by taxpayer. Taxpayer's contention that it adopted this agreement by virtue of the assignments relating to the pipe-line construction contracts (Pet. 14) rests, as the Tax Court concluded, on "farfetched inference" (R. 47). For example, none of these assignments was executed by taxpayer (R. 113–123), and the promoters did not use the conditional agreement to secure credit for taxpayer exclusively (R. 122–129). The fact that the agreement may have been undertaken with the intention that taxpayer would carry it out is without significance. Cf. *Phebus Oil Co.* v. *Commissioner,* 134 F. 2d 217 (C. C. A. 5th). More than a tenuous adoption of this nature is required to sustain the burden of proving that the contract was "executed by the corporation" within the precise meaning of that phrase. Cf. *Mastin Realty & Min. Co.* v. *Commissioner,* 130 F. 2d 1003, 1006 (C. C. A. 8th).

A third fatal deviation from the conditions prescribed by Section 26 (c) (2) is the absence of a debt incurred by taxpayer prior to May 1, 1936,

[3] *Glenn* v. *Chess & Wymond,* 132 F. 2d 621 (C. C. A. 6th), relied upon by the taxpayer (Pet. 13) as presenting a conflict, involved no question of timely execution of a contract, for conditions specified in a letter authorizing a loan were fulfilled and credit was extended prior to May 1, 1936.

dischargeable out of its earnings. Even assuming the existence of a binding contract executed by taxpayer with the bank prior to the critical date of the statute, taxpayer clearly did not become indebted to the bank until the loan was actually made on June 18, 1936. As held by the courts below, there is no basis for taxpayer's assertion (Pet. 15–20) that this loan was merely a continuation of indebtedness incurred prior to May 1, 1936, on the various construction contracts. These debts, which did not relate to a disposition of taxpayer's earnings, were fully discharged and a different obligation, new as to terms and creditor, was incurred on June 18th (R. 42). Unquestionably, this did not constitute a renewal or refinancing of indebtedness. *Houston Cotton Exchange Bldg. Co.* v. *Commissioner,* 134 F. 2d 323 (C. C. A. 5th).[4]

This case raises no question of importance in the administration of the tax laws, and there is no conflict of decisions. In view of the fact that the provisions of the statute here involved were not continued in the Revenue Act of 1938, cases involving Section 26 (c) (2) can arise only with respect to income earned during 1936 and 1937.

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[4] The cases relied upon (Pet. 15–20) by taxpayer in this connection are not in conflict. *Commissioner* v. *Haskelite Mfg. Corp.*, 128 F. 2d 902 (C. C. A. 7th), involved the same creditor throughout, with the same conditions imposed by the loans involved, while *Scofield* v. *Valley Pipe Line Co.*, 138 F. 2d 835, decided by the Fifth Circuit., did not even concern a question of continuing or refinancing an existing debt.

CONCLUSION

For the foregoing reasons, the petition for a writ of certiorari should be denied.

Respectfully submitted.

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